STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

ILLINOIS-AMERICAN WATER COMPANY, and THAMES WATER AQUA HOLDINGS, GmbH	)	
	)	Docket No. 01-0832
Joint Application For Approval Of Proposed Reorganization And Change In Control Of Illinois-American Water Company Pursuant To Section 7-204 Of The Illinois Public Utilities Act.	)	

RESPONSE OF JOINT APPLICANTS TO PETITION FOR INTERLOCUTORY REVIEW REGARDING DENIAL OF MOTION TO DISMISS

This is the response of Illinois-American Water Company ("Illinois-American") on behalf of itself and its parent holding company, American Water Works Company, Inc. ("American"), and Thames Water Aqua Holdings, GmbH ("Thames Holdings"), on behalf of itself and its parent holding company, RWE Aktiengesellschaft ("RWE") (collectively, the "Joint Applicants") to the "Petition for Interlocutory Review by the Commission of the Hearing Examiner's Ruling Denying the Motion to Dismiss" ("Petition") filed by the City of Pekin and the City of Peoria (the "Cities") on August 21, 2002. In the Petition, the Cities assert, as did Pekin in the Petition for Interlocutory Review ("Prior Petition") filed previously with regard to denial of its Motion to Consolidate this proceeding with the proceeding initiated to review Pekin's request for approval to condemn facilities of the Company, that the Verified Application ("Application") filed by Joint Applicants in this proceeding is incomplete. (Prior Petition, par. 16). Specifically (Pet., p. 6), the Cities state that the Application is "incomplete, deficient, insufficient and far less than forthright . . . " As in the case of the Prior Petition, the current Petition should be denied.

I. THE APPLICATION IS COMPLETE

In the Petition (p. 2), the Cities reference arguments raised in the Motion to Dismiss that relate to placement in the Application of Applicants' request for approval for inclusion in the corporate structure of an intermediate holding company. The Application, however, is in full compliance with Section 200.100 of the Commission's Rules (83 Ill. Admin. Code § 200.100), which requires that a pleading contain "a plain and concise statement of any facts" upon which the pleading is based. As the Cities recognize (Pet. p. 2), the Application contains 38 paragraphs of detailed information explaining the proposed transaction. Also, with the Application, Joint Applicants filed a voluminous Appendix containing extensive additional information. With regard to potential use of an intermediate company, the Application (App., p. 12) specifically requests that the Commission enter an Order authorizing "Thames Holdings, RWE and any other entity owned or controlled directly or indirectly by Thames Holdings and managed by Thames to acquire control of Illinois-American and American." (emphasis added) Also, as the Cities admit (Pet., p. 2), Exhibit G in the Appendix to the Application states specifically (in a note related to Apollo Acquisition Company) that an intermediate holding company owned by Thames Holdings may be added to the post-merger corporate structure.

Further repeating arguments from the Motion, the Cities (Pet., p. 2) assert inexplicably that Joint Applicants' Exhibit G, sponsored in the Direct Testimony of Mr. Carmedy (filed with the Application; Jt. Appl. Exs. 2.0, G), makes "no mention" of an intermediate holding company. This assertion is false. As a review of the Exhibit indicates, the information referenced above from Exhibit G to the Application also is stated on Joint Applicants' Exhibit G that is a part of the direct evidence. Both Exhibits make it clear that Apollo Acquisition Company (the Thames

subsidiary that will merge with American) will be owned either directly by Thames Holdings or by an "intermediate holding company."

In their zeal to find fault with the Application, the Cities assert (Pet., p. 8) that the Application does not include certain organizational documents referenced in Section 7-204A(a)(2)(i) of the Illinois Public Utilities Act ("Act"). 220 ILCS 5/7-204A(a)(2)(i). The Cities further contend (Pet., p. 8) that Section 7-204A establishes "a mandatory minimum requirement" that applies to the Application. Section 7-204A, however, is inapplicable to the Application in this proceeding. As Section 7-204A quite plainly states:

> This Section 7-204A shall not apply to . . . any public utility which became a subsidiary of another corporation prior to the effective date of this amendatory Act of 1989.

As the Commission is aware, Illinois-American, the public utility seeking approval to reorganize under Section 7-204, was the subsidiary of American prior to the effective date of Section 7-204A (August 15, 1989). Consequently, Section 7-204A does not apply.

The Cities further fail to recognize that Joint Applicants specifically noted in the Application that the requirements of Section 7-204A do not apply to the proposed reorganization because Illinois-American became a subsidiary of American prior to the effective date of Section 7-204A. *See* Ver. App. at 11, note 1. The Application (p. 11, n. 1) goes on to explain that, although Section 7-204A is inapplicable, extensive information listed in the Application is provided in the Application's Appendix. Neither the Cities nor any other party to this proceeding has asserted (nor can they assert) that Joint Applicants failed to provide in evidentiary filings and/or responses to discovery requests documents or information related to the transaction. For all these reasons, the Cities' assertion that the Application is deficient because it did not include material referenced in an inapplicable statute is baseless.

II. TWUS IS NOT A "NECESSARY PARTY"

The Cities (Pet., pp. 3-5) also repeat the argument raised in the Motion that the intermediate holding company is a necessary party to the Application and suggest (Pet., p. 3) that, if the Application is approved without addition of the intermediate company as a party, "the Commission will have no jurisdiction over that corporation." As in the Motion to Dismiss, the Cities cite no legal basis for their argument.

In fact, Section 7-204 grants authority to the Commission to approve any "reorganization," as that term is defined in the Section. For this reason, Illinois-American (the public utility that proposes to reorganize) and the other Joint Applicants filed the Application, seeking approval of the reorganization, including, as noted above, a specific request in the Application (p. 12) for authority to include an intermediate holding company in the corporate structure. Section 7-204 does not refer at all to "necessary" parties, and there is no basis for the Cities' assertion that an intermediate holding company included in the corporate structure must be a "party" to an application filed under the Section.

The case law makes it clear that no such requirement exists. For example, in Consumers Illinois Water Company ("CIWC") and Philadelphia Suburban Corporation ("PSC"), Docket 98-0602 (Jan. 21, 1999), the Commission approved a reorganization under which the parent of an Illinois utility, Consumers Water Company ("Consumers"), merged into a subsidiary of PSC, with the result that the PSC subsidiary (now called Consumers Water Company) became an intermediate holding company for the utility. The intermediate holding company, however, was not a "party" to the application. Similarly, in Northern Illinois Water Corp. ("NIWC"), Docket 99-0093 (May 5, 1999), the Commission approved a reorganization in which American Water Works Company, Inc. ("American") acquired the capital stock of National Enterprises,

Inc., ("NEI"), the parent of Continental Water Company ("Continental"). Continental, in turn, owned all of the voting capital stock of the utility, NIWC. The only "party" filing the application, however, was NIWC. Neither of the merging holding companies, American and NEI, nor the intermediate holding company, Continental (which continued to exist) was a "party" to the application. Later, in Illinois-American Water Company and Northern Illinois Water Corp., Docket 99-0418 (March 31, 2000), the Commission approved the transfer of ownership of NIWC's common shares to Illinois-American and, in conjunction therewith, a transfer of the portion of Illinois-American's common shares with a book value equivalent to that of NIWC's common shares to Continental. The Commission also approved the subsequent transfer of the common shares of Illinois-American held by Continental to American. Only the two Illinois utilities, Illinois-American and NIWC, however, were "parties" to the application. Neither Continental nor American, respectively the intermediate and ultimate holding company, was a listed "party."

Thus, there is nothing in the language of Section 7-204 or in Commission Orders issued under that Section which supports the position that an intermediate holding company of the type proposed by the Joint Applicants is a "necessary party" to an application for approval of a reorganization. Under Section 7-204, the Commission has authority to review a reorganization transaction, and such review is properly sought by the utility proposing to reorganize. Under the Commission's rules, other entities may join the utility in seeking approval of a reorganization, but there is no requirement that they do so.

The intermediate Company referenced in the Application and direct evidence was incorporated prior to the hearing held in this proceeding on July 31, 2002, as Thames Water Aqua U.S. Holdings, Inc. ("TWUS"). [Tr. 255.] The Cities suggest (Pet., p. 3), however, that

the Application is invalid because it could be filed only after TWUS was incorporated. As noted above, however, the Commission's jurisdiction under Section 7-204 is over the transaction, and that jurisdiction is in no way affected by the fact that the intermediate holding company was not formed until after the Application was filed.

Section 7-204(f) states expressly that, in approving a reorganization, the Commission may impose such terms, conditions or requirements as, in its judgment, "are necessary to protect the interests of the public utility and its customers." Contrary to the unsupported assertion of the Cities (Pet., p. 3), the fact that an intermediate holding company is not a party to the Application or not formed until after the Application is filed in no way affects the Commission's authority in this regard. This is, because, with respect to reorganization transactions and other matters involving affiliated companies, the Commission exercises its regulatory powers by means of its comprehensive jurisdiction over the public utility, and its specified jurisdiction over affiliated companies under Section 7-101 of the Act.

Moreover, on August 16, 2002, the Cities submitted an Initial Brief in this proceeding to which the Cities appended an Order issued by the Kentucky Public Service Commission ("KPSC") with regard to the transaction proposed in this proceeding. (Ky. PSC, Case No. 2002-00018). At pages 9-12, the Kentucky Order addresses an argument raised by intervenors in the Kentucky proceeding that is similar to the argument raised by the Cities with regard to "necessary parties." In rejecting the argument, the KPSC notes that its jurisdiction under the applicable Kentucky statute is "over any transfer of control of a utility." [KPSC Order, p. 10.] The KPSC further states as follows:

> The statute confers jurisdiction over the transaction regardless of the parties. This jurisdiction is based upon KAWC's status as a utility and the nature of the proposed transaction. Commission approval of the transaction must be obtained. (emphasis added)

KPSC Order, p. 11. As in the case of the KPSC's jurisdiction under the Kentucky statute, the Commission's jurisdiction under Section 7-204 is based on the regulated entity's (in this case, Illinois-American's) "status as a utility and the nature of the proposed transaction."

III. OTHER ISSUES

The Cities suggest (Pet., p. 7), without explanation, that the manner in which information about TWUS was disclosed was somehow "underhanded." The Cities also attribute concerns about "underhanded" disclosure to the Administrative Law Judge ("ALJ") and the Commission Staff. Neither the ALJ nor Staff, however, have said anything about perceived underhanded disclosure.[1] The Cities offer nothing in support of their accusation, other than baseless argument replete with error.

According to the Cities (Pet., pp. 6-7), Joint Applicants "have attempted to shift the blame for the inadequacies of their Application to the Cities." As explained above, however, the Application is not inadequate or deficient in any respect. Accordingly, there is no "blame" to shift, and Joint Applicants have said nothing about a shifting of blame. Joint Applicants, however, have pointed out that the Cities' expression of "concern" over the intermediate company is puzzling in light of the undisputed fact that, prior to the hearing held in this matter on May 21, 2002, neither of the Cities referred at all to the intermediate holding company

[1] In this regard, the Cities refer to a recommendation of Staff witness Johnson regarding the need for Commission approval of future reorganizations. [ICC Staff Ex. 7.00, p. 5.] Mr. Johnson's recommendation, however, is based on concern about the potential future effect of a Section of the Agreement and Plan of Merger (ICC Staff Ex. 7.00, p. 4), and has nothing to do with the Cities' allegation of underhanded disclosure. Thus, the Cities plainly misrepresent Mr. Johnson's position. In any event, Joint Applicants willingly accepted the recommendation of Mr. Johnson. [Jt. Appl. Ex. 8.]

(although its possible use was disclosed in the Application and Direct Testimony filed 5 months before). Prior to May 21, neither of the Cities raised a question about the intermediate holding company issue either in data requests or testimony. Once Staff and the Intervenors expressed an interest in the intermediate holding company issue during the evidentiary hearing,[2] Joint Applicants responded and have since supplemented the record with additional information concerning the proposed intermediate company and have responded to extensive discovery requests--including discovery requests filed by the Cities--addressing the issue. In this regard, and as the record shows, Joint Applicants confirm in the Supplemental Testimony of Stephen Smith that TWUS has been established for the purpose of filing a consolidated U.S. income tax return for U.S. businesses owned by Thames Holdings. [Jt. Appl. Ex. 7, p. 2.]

The Cities (Pet., p. 7) also reference the fact that the reason for inclusion of TWUS in the corporate structure is to permit the filing of a consolidated tax return for the businesses owned by Thames Holdings in the United States. In a discussion with no apparent connection to the Motion to Dismiss, the Cities then set forth a garbled sentence, unsupported by the record, which suggests that the purpose of filing a consolidated tax return is to "reap the benefit of savings." The Cities (Pet., p. 7) then note that the filing of a consolidated tax return would not result in savings for Illinois-American.

What the Cities fail to point out is that neither the formation of TWUS nor the filing by TWUS of a consolidated tax return will have any effect at all on Illinois-American. Illinois-American will not incur any cost related to TWUS. [Jt. Appl. Ex. 7, p. 4.] Furthermore, American has historically filed a consolidated tax return, precisely as Thames proposes to do.

[2] Of course, the fact that the Cities conducted cross-examination at the May 21 hearing with respect to the intermediate holding company issue itself demonstrates that the issue was properly raised in the Joint Application and evidentiary presentation, as there would have been no reason for them to conduct cross-examination addressing the issue had it not been properly raised.

For ratemaking purposes, however, Illinois-American's income taxes have consistently been computed on a "stand-alone" basis (Jt. Appl. Ex. 7, p. 4.) -- a ratemaking approach that has been applied by the Commission for decades in setting rates for Illinois utilities that are subsidiaries of other entities. As is presently the case with the consolidated tax return filed by American, the consolidated tax return filed by TWUS will have no effect at all on Illinois-American's stand-alone tax liability. [Jt. Appl. Ex. 7, p. 4; Tr. 264.] Consequently, under the stand-alone approach, Illinois-American will continue to incur no costs attributable to other entities in the holding company structure, and no savings attributable to those entities.

IV. CONCLUSION

For the reasons discussed herein, the Petition should be denied.

Respectfully submitted,

Boyd J. Springer
JONES, DAY, REAVIS, & POGUE
77 West Wacker
Chicago, IL 60601-1692
Phone: 312/782-3939
Fax: 312/782-8585

Counsel on behalf of Illinois-American and American.

Stephen J. Mattson
Angela D. O'Brien
MAYER, BROWN, ROWE & MAW
190 South LaSalle Street
Chicago, IL 60603-3441
Phone: 312/782-0600
Fax: 312/701-7711

Counsel on behalf of Thames Holdings and RWE.

Dated: August 27, 2002

VERIFICATION

I, Boyd J. Springer, certify that: (i) I am an attorney for Illinois-American Water Company and American Water Works Company, Inc.; (ii) I have read the attached "Response of Joint Applicants to Petition for Interlocutory Review Regarding Denial of Motion to Dismiss"; (iii) I am familiar with the facts stated therein; and (iv) the facts are true and correct to the best of my knowledge.

Boyd J. Springer

SUBSCRIBED and SWORN to before me
this 21th day of August, 2002.

Maurine E. Wilcher
Notary Public

OFFICIAL SEAL
MAURINE E WILCHER
NOTARY PUBLIC, STATE OF ILLINOIS
MY COMMISSION EXPIRES:07/20/03

VERIFICATION

I, Angela D. O'Brien, certify that: (i) I am an attorney for Thames Water Aqua Holdings, GmbH; (ii) I have read the attached "Response of Joint Applicants to Petition for Interlocutory Review Regarding Denial of Motion to Dismiss"; (iii) I am familiar with the facts stated therein; and (iv) the facts are true and correct to the best of my knowledge.

Angela D. O'Brien

SUBSCRIBED and SWORN to before me
this 27th day of August, 2002.

Deborah L. Schumal
Notary Public

"OFFICIAL SEAL"
Deborah L. Schumal
Notary Public, State of Illinois
My Commission Exp. 01/19/2006